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SUBJECT: ARGENTINA -- 2006 INVESTMENT CLIMATE STATEMENT  
(PART 1 OF 2)

REF: 05 STATE 202943

The following is Part I of the 2006 Investment Climate  
Statement for Argentina. Begin Text:

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A.1. Openness to Foreign Investment  
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Argentina is open to foreign investment. Argentina ended its 1-to-1 conversion rate with the U.S. dollar in January 2002 and pesified bank accounts and contracts. The move to a market-based exchange rate regime has altered the investment situation substantially from that of the 1990s, when the country's flexible investment regime and fixed 1-to-1 conversion rate with the US dollar (USD) spurred significant foreign investment. Many sectors that were uncompetitive under peso-dollar parity (convertibility) now offer investment opportunities, even while the pesification of dollar-denominated contracts undermined the financial base for many existing foreign investments. The Kirchner Administration encourages new foreign investment and has expressed a preference for U.S. companies. Legal uncertainties continue concerning creditor, contract and property rights, and frequent and unpredictable regulatory changes have diminished the attractiveness of some sectors for foreign investors.

Then-president Menem imposed convertibility in 1992 to break the back of hyperinflation and adopted far-reaching market-based policies. Menem's accomplishments included dismantling a web of protectionist trade and business regulations, and reversing a half century of statism by implementing an ambitious privatization program. These reforms contributed to significant increases in investment and growth with stable prices through most of the 1990s. Unfortunately, widespread corruption in the Menem and successor De la Rúa administrations shook confidence and weakened the recovery. Also, while convertibility defeated inflation, its permanence undermined Argentina's export competitiveness and created chronic deficits in the current account of the balance of payments, which were financed by massive borrowing.

The country was also hurt by the contagion effect of the Asian financial crisis of 1998. Argentina went into recession in late 1998, which deepened into depression that

culminated in a financial panic in late. In December 2001, amidst bloody riots, President De la Rúa resigned, and Argentina defaulted on USD 88 billion in debt, the largest sovereign debt default in history. In February 2005, investors holding 76 percent of Argentina's defaulted principal accepted a government offer of approximately 30 cents per dollar face value of old debt in what became the largest sovereign restructuring in history. As of this writing, the government of Argentina has not presented a plan for dealing with bondholders who chose not to participate in the restructuring.

An export-led boom has spurred a surge in real GDP growth over the past three years. Argentina's economy grew 8.7 percent in 2003, 9.0 percent in 2004, and is projected to grow 8.3 percent in 2005. Industrial activity and construction have performed well, growing 7.7 percent and 13.9 percent, respectively, during the first eleven months of 2005. Domestic car sales and exports increased 33.9 percent and 26.7 percent, respectively, in the first eleven months of 2005. Tourism has soared, with Argentina receiving an estimated 3.7 million foreign tourists in 2005, a record.

The expansion is creating jobs, and unemployment dipped from 16.3 percent in the third quarter of 2003 to 11.1 percent during the third quarter of 2005. Investment in real terms is forecast by the Central Bank to have jumped 18.3 percent in 2005, and capital flight reversed. The recovery's strong impact on revenue levels and the Kirchner Administration's sound fiscal policy achieved exceptional results, with the federal fiscal surplus reaching approximately 3.7 percent of GDP in 2005 (although federal public spending grew a nominal 23.4 percent annually in the first three quarters of 2005).

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Provincial fiscal figures for 2005 are very preliminary at this writing, so it is difficult to include consolidated fiscal figures for both the national and provincial governments. The consolidated primary surplus was 5.1 percent of GDP in 2004. However, the tax burden is now nearly 27 percent of GDP, up from 21 percent in 2000.

Meanwhile, the move to a market-based exchange rate regime and high global commodity prices have lifted exports to record levels and, together with a sharp decrease in imports in 2002, assured hefty surpluses in Argentina's trade and current accounts of the balance of payments. The favorable balance of payments performance and Argentina's non-payment of its private debt obligations allowed a strong accumulation of foreign exchange reserves, which reached nearly USD 28.1 billion at the end of 2005, representing 11.8 months of current imports. However, the GOA in early 2006 used reserves to cancel all of Argentina's debt with the IMF, so reserves dropped by approximately USD 9.5 billion in one transaction. Argentina's remaining reserves represent approximately 7.7 months of current imports. The demand for pesos increased over 125 percent between November 2002 and November 2005 due to the recovery of economic activity and the appreciation of the peso.

Argentina's Central Bank has ably managed monetary policy in support of the economic expansion, achieving low interest rates and relatively stable prices, although inflation is a growing concern. Banks are now in the black on an operating basis and net credit levels to the private sector are positive. However, most bank deposit growth derives from short-term, public sector deposits, and therefore cannot serve as the basis for a long-term credit policy for private sector financing. Banks also report that demand for commercial credit remains low. As a consequence, credit growth to the private sector has lagged growth in the economy.

Argentina's impressive recovery is a function of a number of factors. First, following a decade of market reforms, the economy was fundamentally sound except for the high level of indebtedness. Second, the adoption of a market exchange rate

and favorable international commodity and interest rate trends were catalytic factors in the export-led boom. Argentina's successful debt exchange and prepayment of its IMF debt will likely strengthen the country going forward, and Argentina should continue to perform well in 2006, with growth projected to be in the 5-7 percent range.

Decree 1853/1993 governs foreign investment in Argentina. According to this decree, foreign companies may invest in Argentina without registration or prior government approval, and on the same terms as investors domiciled in Argentina. Investors are free to enter Argentina through merger, acquisition, greenfield investment, or joint venture. Foreign firms may also participate in publicly financed research and development programs on a national treatment basis. In June 2003, Argentina enacted legislation limiting foreign ownership of "cultural goods," which includes media and Internet companies, to 30 percent. An exception to the 30 percent limit is made for investors from those countries whose foreign investment regimes allow more than 30 percent foreign ownership of cultural goods. This law also exempts media companies from "cramdown" rules in restructuring and bankruptcy.

A Bilateral Investment Treaty (BIT) between Argentina and the United States entered into force in October 1994. The BIT provides protections against capital movement restrictions, expropriations, and performance requirements; it also establishes effective means for the settlement of investment disputes. The BIT lists a few sectors in which Argentina maintains exceptions to national treatment for U.S. investors: real estate in border areas, air transportation, shipbuilding, nuclear energy, uranium mining, and fishing. U.S. investors must obtain permission from the Ministry of Defense's Superintendency for Frontiers to invest in non-mining activities in border areas.

Foreign and Argentine firms face the same tax liabilities. In general, taxes are assessed on consumption, imports and

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exports, assets, financial transactions, and property and payroll (social security and related benefits). In June 2003, Argentina announced that it would review more closely the tax declarations of foreign corporations operating in Argentina. The professed aim of this measure is to crack down on the use of offshore shell corporations to shelter profits and assets from taxation.

The government of Argentina has established a number of investment promotion programs. Those programs allow for VAT refunds and accelerated depreciation of capital goods for investors; offer tariff incentives for local production of capital goods; and include sectoral programs, free trade zones, and a special Foreign Trade Area in Tierra del Fuego, among other benefits. A complete description of the scope and scale of Argentina's investment promotion programs can be found at <http://www.industria.gov.ar/>. Information about programs that specifically apply to small and medium businesses may be found at <http://www.sepyme.gov.ar/>.

## ----- A.2. Conversion and Transfer Policies -----

Until the end of 2001, Argentine law offered a number of protections for free capital and currency transfers. Law 21382, Article 5 (as implemented by Decree 1853/1993), allows foreign investors to repatriate capital and remit earnings abroad at any time. Article V of the United States-Argentina BIT also provides for free, prompt transfers related to investments. In the wake of the 2001-2002 crisis, however, the government of Argentina instituted and subsequently modified an array of emergency transfer and currency conversion restrictions. The number of new regulations and the frequency of policy changes have generated considerable

uncertainty for investors.

The Central Bank has issued various new or revised foreign exchange transaction regulations in an attempt to normalize the foreign exchange market and to limit the peso's appreciation. Note: In nominal terms, the peso appreciated 22 percent against the USD in 2003, 13 percent in 2004, and did not change in relation to the USD during 2005. Central Bank Communication 46806 eliminated the requirement to have the Central Bank authorize principal payments on financial debt. This communication also allows exporters to surrender export proceeds to financial institutions instead of only to the Central Bank. Subsequently, Central Bank Circular 4128 increased to USD 2 million per month the amount of foreign currency that an individual or company can purchase without Central Bank authorization. There are special rules regulating the purchase of foreign currency to settle financial debt, and for the private issuance of bonds denominated in foreign currency.

Argentina imposed limited capital controls in July 2003 through Decree 285/2003, which establishes a regimen for capital inflows and outflows. The decree obliges investors to keep foreign currency inflows in the country for a period of at least 180 days. Central Bank Circulars 3972 and 3973 implement Decree 285/2003. Circular 3972 mandates that any financing received from the financial or non-financial sector must remain in the country for a minimum of 180 days. Circular 3973 eases access to the foreign exchange market to repay financing in advance. The Central Bank may continue easing capital controls in the future.

Decree 260/2002 lifted official conversion rates that had been established in early 2002. With this decree, the market determines the rate of exchange, with Central Bank intervention, and subject to rules established by the Central Bank. The Central Bank intervenes frequently in the foreign exchange market, with the objective of maintaining a competitive peso.

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A.3. Expropriation and Compensation  
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Article 4 of the United States-Argentina BIT states that investments shall not be expropriated or nationalized except

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for public purpose upon payment of prompt fair-market value compensation. However, some U.S. investors claim the January 2002 pesification of dollar-denominated contracts amounts to an effective expropriation of their investments. A number of these investors have filed international arbitration claims against the government of Argentina.

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A.4. Dispute Settlement  
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The government of Argentina accepts the principle of international arbitration. The United States-Argentina BIT provides for binding international arbitration of investment disputes that cannot be settled through amicable consultation and negotiation between the parties. The government of Argentina is a party to the International Center for the Settlement of Investment Disputes (ICSID), The United Nations Commission on International Trade Law (UNCITRAL), and the World Bank's Multilateral Investment Guarantee Agency (MIGA). Companies that seek recourse through Argentine courts, however, may not also pursue recourse through international arbitration.

In April 2003, the government of Argentina issued Decree 926/2003, which created two new agencies to carry out amicable negotiations under bilateral investment treaties, including the United States-Argentina BIT. The "Amicable Negotiations Federal Council" (ANFC) made up of

representatives of the Ministry of Foreign Affairs, the Ministry of Economy and the Federal Attorney General's Office, had a mission to devise the government's strategies and policies in negotiations with foreign investors and could approve proposals made during negotiations. However, in July 2003 that body was replaced by the Unit for the Renegotiation and Analysis of Utility Contracts (UNIREN), which was created to serve essentially the same function, but which is presided over jointly by the Ministers of Planning and Economy. The other entity created by Decree 926/2003 is the "Amicable Negotiations Proceedings Body," which works under the Federal Attorney General. It receives investor complaints, gathers information and carries out negotiations with foreign investors.

Domestic investment dispute adjudication is available through local courts or administrative procedures. However, independent surveys indicate that public confidence in the Argentine judiciary remains weak. Therefore, many foreign investors rely on private or international arbitration when those options are available. Argentina has a strict bankruptcy law similar to that of the United States. However, initiating bankruptcy proceedings is more difficult in Argentina. Creditors can participate in a Chapter 11-like procedure to determine the best means of recovering debts from a bankrupt firm. Company directors are personally and criminally responsible in cases of fraud, although severe punishment for white-collar crime is rare. There have been allegations of corruption in the administration of bankruptcies and the selection of bankruptcy trustees.

As noted above, a number of U.S. investors have filed ICSID arbitration claims against the government of Argentina. Most of these investors consider the January 2002 pesification of dollar-denominated contracts, and/or the ex post facto prohibition on contracts linked to foreign inflation indices, to be an effective expropriation of their investments. Prior to pesification, some U.S. investors engaged in disputes with provincial governments over unforeseen changes in tax laws and liabilities (often in spite of tax-stability guarantees from provincial and federal authorities). Customs treatment and the freeze on public utility rate changes have also provoked investment disagreements. There were 36 disputes involving Argentina in international arbitration as of December 15, 2005, and the number is expected to grow in 2006. The amount claimed in these disputes exceeds USD 15 billion. However, several ICSID claimants, including at least one U.S. claimant, withdrew their claims during 2005 after successful negotiations with the Argentine government.

In addition, there are thousands of administrative and

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judicial claims against the government of Argentina at the local level. The government of Argentina is pressuring ICSID claimants who hold public service contracts to drop their claims in exchange for the re-negotiation of their contracts.

All 62 public service contracts were supposed to be re-negotiated by December 31, 2004, but only a few (less than five) were concluded by that date, and even those were concluded on a temporary basis. The pace of contract renegotiations picked up in 2005, however. By November 2005 fifteen contracts had been renegotiated outside the formal renegotiation process while twenty-five had been renegotiated within that process. The remaining twenty-two were still in negotiations as of this writing.

There also remains substantial legal uncertainty about the value of pesified contracts and the legality of pesification.

Thousands of depositors have gone to court challenging the constitutionality of the pesification of their dollar-denominated bank accounts and have obtained judgments obligating their banks to repay them in dollars or in pesos at the market rate of exchange. The Supreme Court, in a July 2004 decision involving a province's deposits at a state bank, ruled that pesification was unconstitutional, but did

not extend that ruling to other cases involving other depositors. In another ruling, this time in late October 2004, the Supreme Court ruled that pesification of a bank account was constitutional. However, the five justices deciding the case issued four separate opinions that had little in common. Additionally, lower courts in Argentina are not required to follow a Supreme Court decision except in the particular case ruled upon, and lower courts have largely ignored this decision and continue to issue orders to banks to pay depositors.

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#### A.5. Performance Requirements and Incentives

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No performance requirements are aimed specifically at foreign investors. Government incentives apply to both foreign and domestic firms. The Ministry of Economy administers a complex trade-balancing regime involving quotas and tariffs for auto manufacturers based on minimum-content and other requirements. Special regimes also apply to mining, oil and gas, and other natural resource sectors. The special regimes allow producers to keep all (as in the case of mining) or 70 percent of their foreign exchange revenues off-shore (as in the case of oil and gas, fisheries and forestry).

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#### A.6. Right to Private Ownership and Establishment

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Foreign and domestic investors have free and equal rights to establish and own businesses, or to acquire and dispose of interests in businesses without discrimination. However, as noted above, in June 2003 Argentina enacted legislation limiting foreign ownership of "cultural goods," which includes media and Internet service providers companies, to 30 percent. The Embassy is monitoring a case in which U.S. media investors allege that the government of Argentina, citing the "cultural goods" law, has refused to recognize their ownership stake. An exception to the 30 percent limit is made for investors from those countries whose foreign investment regimes allow more than 30 percent foreign ownership of cultural goods. This law also exempts media companies from "cramdown" rules in restructuring and bankruptcy.

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#### A.7. Protection of Property Rights

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Secured interests in property, including mortgages, are recognized and common in Argentina. Such interests can be easily and effectively registered. They also can be readily bought and sold. However, since February 2002, the government of Argentina has continued to extend a temporary moratorium prohibiting financial institutions from foreclosing on delinquent mortgages on primary residences.

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The last extension of the moratorium came on November 4, 2005, and provided protection to homeowners' primary residences for another 120 days. In another case, the government of Argentina intervened to prevent a secured creditor from repossessing leased locomotives from a railroad concessionaire, citing "public service" needs. The government of Argentina has neither offered nor paid compensation for the continued retention of the locomotives.

The government of Argentina adheres to most treaties and international agreements on intellectual property and belongs to the World Intellectual Property Organization and the World Trade Organization (WTO). The Argentine Congress ratified the Uruguay Round agreements, including the provisions on intellectual property, in Law 24425 on January 5, 1995. However, enforcement of intellectual property rights is problematic in Argentina.

## Patents:

Patent law is the weakest element in Argentina's intellectual property rights regime, and extension of adequate patent protection to pharmaceuticals has been a highly contentious bilateral issue. In early 1997, the U.S. announced the suspension of 50 percent of Argentina's trade benefits under the Generalized System of Preferences (GSP) because of inadequate protection of pharmaceutical products. In November 2000, after years of protracted debate, a new patent law took effect and a number of pharmaceutical patents were issued. This law improved earlier Argentine patent legislation, but provides less protection than that called for in the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS). In April 2002, the United States and Argentina reached an agreement with respect to most of the claims in a World Trade Organization (WTO) dispute brought by the United States with respect to Argentina's implementation of its TRIPS obligations. Two issues, including the critical issue of data protection, remain unresolved. The United States and Argentina have agreed to leave these issues within the WTO dispute settlement mechanism for action. Legislation implementing the April 2002 agreement was passed in December 2003. However, certain U.S. and European pharmaceutical firms are concerned that provisions in the legislation could undercut the limited success they have achieved in protecting their products through judicial injunctions.

## Copyrights, Trademarks, Trade Secrets, and Semiconductor Chip Layout Design:

The legal framework to protect intellectual property such as books, films, music, and software in Argentina has improved in recent years. However, the economic crisis of 2002 led to an increase in the use of unlicensed software and optical media. Argentine authorities continue their efforts to combat the piracy of videotape, software and other copyrighted material, but enforcement continues to be sporadic and pirated products are still available in the market. That said, Argentine authorities began in late 2004 to show signs of a more proactive posture regarding product piracy. Specifically, the government of Argentina passed laws designed to allow authorities to mount undercover operations for the first time; to electronically flag suspect shipments; to facilitate the seizure and detention of suspect merchandise; and to more frequently rotate customs personnel, among other provisions. The government has also improved the process for trademark registration. Argentina has no specific law on trade secrets, although penalties for unauthorized revelation of secrets are applied to a limited degree under commercial law. Argentina has signed the WIPO Treaty on Integrated Circuits, but has no law dealing specifically with the protection of layout designs and semiconductors.

## ----- A.8. Transparency of the Regulatory Regime -----

During the 1990s, the government of Argentina eliminated virtually all restrictions on domestic and foreign trade of

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goods and services, as well as on financial markets. These policies increased competition in many industries and sectors. Argentine authorities, including the Ministry of Economy and a number of quasi-independent regulatory entities, have also acted in certain cases to foster competition and protect consumers, though not always in a transparent fashion.

Frequent changes to the bankruptcy law during early 2002 increased creditor insecurity. In January 2002, the Argentine National Congress passed several amendments to the

bankruptcy law that increased debtor's powers considerably, but the National Congress restored many of the law's earlier protections for creditors in May of that year.

Other regulatory changes in 2002 added to creditor insecurity. The government announced in May 2002 that an emergency decree passed in late 2001 had voided the presidential decree that authorized oil and gas companies to keep 70 percent of their foreign exchange revenues offshore. This decree formed the financial basis for most foreign investment in the Argentine oil sector. The government's discovery that the decree had been voided inadvertently months before came at a time when the government of Argentina was worried about its access to foreign exchange and the devaluation of the peso. When the peso began to appreciate, the government of Argentina issued a new decree that gave the industry the same right to withhold 70 percent of revenues starting January 1, 2003, but the industry remains liable for failing to repatriate 100 percent of its revenues during the 13-month period from December 2001 and December 2002. The Central Bank opened proceedings against some oil and gas producers in 2004 for alleged criminal breach of the exchange regime.

The government's actions since 2003 have not calmed investor concerns about the regulatory environment. The government of Argentina issued a decree de-pesifying foreign currency-denominated contracts of foreign firms doing business in Argentina in 2003, but then withdrew the decree and said it was a mistake. In the energy sector, the government of Argentina took measures to avoid energy shortages that arose from the increase in demand for natural gas and electricity in 2004: ordering reductions in natural gas exports to Chile and electricity exports to Uruguay; importing natural gas from Bolivia and electricity from Brazil; raising tariffs for industrial users; providing incentives to small users to save energy; and intervening in the wholesale markets for natural gas and electricity. The government of Argentina has also pressured companies to invest in the expansion of natural gas pipelines, and has pressured power companies to invest compensation owed them by the government of Argentina in power plants the government of Argentina wishes to construct. There is a concern that the abovementioned GOA actions in the energy sector, coupled with the GOA's attempts to control retail prices of fuels, have created disincentives for companies to invest in energy exploration and infrastructure. Inadequate investment in those areas could in turn result in energy supplies not keeping pace with demand generated by Argentina's rapid economic growth.

In general, national taxation rules do not discriminate against foreigners or foreign firms (e.g., asset taxes are applied to equity possessed by both domestic and foreign entities). Nevertheless, a number of these taxes may impact their investment decisions. As noted above, in June 2003, the government of Argentina announced that it would review more closely the tax declarations of foreign corporations operating in Argentina. The professed aim of this measure is to crack down on the use of offshore shell corporations to shelter profits and assets from taxation.

At the national level, there are two major taxes: the income tax and value added tax ("VAT"). The income tax law presumes that every company earns a profit, and based on this presumption, all firms are required to pay one percent of the value of their assets involved in the production process to the state. If a company is later able to establish that it did not earn a profit, the company will be reimbursed in five

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years. The VAT is set at 21 percent for most products. The VAT is 10.5 percent for interest and commissions on debts taken by public transportation companies, fruits, vegetables, honey, newspapers and magazines, and some capital goods. The VAT is 27 percent for natural gas, electricity, water and



sewage services. Exporters should receive VAT rebates, but many companies have experienced extensive delays in the receipt of these rebates.

At the provincial level, the system of provincial sales taxes has encouraged the vertical integration of firms. Investors also have expressed increasing concern over the incidence of municipal "supply taxes". The Argentine constitution gives municipalities the right to set fees for the services that they provide, including supply taxes. Many investors allege that the supply tax fees charged by municipalities do not correspond to the services provided. Municipalities have levied fees on the food industry, in particular, through a range of sanitary controls that occasionally overlap national and provincial regulations. Supply tax fees have affected other industries as well. Municipalities in Buenos Aires and Cordoba provinces have generated the most serious complaints.

Many municipalities have begun imposing fees on any advertising visible from the public street, including in-store promotion materials, such as soft drink coolers, ashtrays and the packaging of individual consumer items, such as batteries.

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